

THE
SINKING-FUND.

BY

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THE SINKING-FUND.

WHEN Sir Robert Walpole, a century and a half ago, established a sinking-fund, he did it with the concurrence of both houses of parliament, and in the full confidence in the merits of the scheme, and in the hope that, within a reasonable period, susceptible of accurate computation, the national debt of Great Britain would thereby be paid and extinguished. When, some twenty years later, having been in the mean while charged with perverting the fund to corrupt uses, he took the accumulated treasure and applied it towards defraying the ordinary charges of government, he did it with equal assurance that he was administering the finances of the country to the best advantage.

A half century afterwards, Pitt revived the scheme amidst the enthusiastic applause, not of his own party only, but of the opposition, led by Fox himself. Pitt's sinking-fund survived, with various fortune, sometimes accumulating, sometimes trenched upon, as the needs of the exchequer and the vicissitudes of the kingdom made expedient, throughout the wars of the French Revolution and of the Empire ; and it was not until the year of grace 1829 that parliamentary enactments on the subject were finally brought to a close.

Reflecting men had long previously been led to suspect that there must be some fallacy at the bottom of a scheme, which looked so plausible in its statement, so promising for the absolute extinction of the national debt, but during the existence of which, the national debt had in fact increased three or four hundred-fold, — in great part, indeed, from the requirements of war, but in part also from the exigencies of the country in time of peace.

But it was a Scotchman, Professor Hamilton, of Aberdeen, who finally pricked the bubble, exposed its utter hollowness, and laid bare to the minds of those islanders that it was an *ignis fatuus* they had been following. He demonstrated to them, so clearly that there was no gainsaying it, that it was a delusion to suppose there was any mysterious self-generating or self-increasing power in a sinking-fund, accumulating by compound interest or otherwise, by which the payment or extinguishment of public or corporate debt could be made easier than by the primitive, commonplace, however disagreeable, method of actual direct counting out of the coin or its equivalent.

The South Sea bubble and Law's Mississippi scheme each had likewise in view, or at least held out the alluring hope of, the extinguishment of public debt by financial legerdemain. Those schemes both suddenly collapsed, with disaster and confusion; and the sinking-fund delusion in England, if it lived much longer and at length died an easier and a lingering death, came also to as complete and effectual an end.

But the idea of a sinking-fund still retains its hold in the American mind. The great State of New York,

as it leads in population and wealth, furnishes also the example of a sinking-fund, by means of which its debts are certainly to be paid, without trouble, without taxation, at least without being felt by the taxpayers, so easy is to be the process of depletion on the one hand, and so rapid that of accumulation on the other. True, the fund has shared, in times past, the fate, and, should exigencies sufficiently pressing occur, may again share the fate which has sometimes befallen other sinking-funds, which not unfrequently befel the British sinking-fund, of being used, instead of borrowing, for the ordinary or extraordinary disbursements of the treasury. But all deficiencies have now been made up, whether by taxation in part or chiefly by loans does not fully appear. But the New York fund is again entire.

Massachusetts also has its sinking-fund, invested partly in its own securities, and more largely in the obligations of the cities and towns of the Commonwealth; thereby giving much official encouragement to those municipalities to indulge in the luxury of running into debt. Other States, and a great number of corporations, municipal and private, have their sinking-funds, which are relied upon for the payment of bonded debt. So deep-seated is the delusion on this subject, that corporations wishing to borrow money sometimes obtain more than they want, in order to set apart a portion of the borrowed sum as a sinking-fund for the ultimate redemption of the whole; under the marvellous hallucination, which the lender also generally participates in, that the more they owe up to a certain point, the more able they

will be to meet their obligations. The absurdity of this paradox is not more transparent than that of the still more frequently exhibited species of financial charlatanry of hiring annual sums in order to keep up an already existing sinking-fund.

It may be stated as a general proposition, which hardly admits of qualification, that a debtor, whether a state, or a corporation, private or municipal, never gains any thing, never derives any advantage whatever from the creation or the continuance of a sinking-fund. On the contrary, he is worse off by reason of its existence, to the extent at least of the cost of its management, and also to the extent of the risk of loss by depreciation and mismanagement. There is but one road to the payment of debts, public or private, and that is by raising revenue enough above ordinary expenditures; earning money enough above expenses to pay them. Whether the money thus raised or earned is applied directly to the extinguishment of liabilities, or is deposited as a sinking-fund to accumulate until the liabilities mature, may not seem at first view so material. In either event, the debtor must raise the money, and the whole of the money, by earnings or by taxes first or last, by which payment is actually made. By no device, by no jugglery, can he evade that stern necessity. If the debtor borrows money to establish or keep up a sinking-fund, or, what amounts to the same thing, if he borrows money for his ordinary expenditures in order thereby to have a surplus to put into his sinking-fund, he is simply increasing his liabilities, and complicating his accounts to no good purpose. If, moreover, as

often happens, especially in the financial business of the larger cities, the borrowing is at seven per cent or upwards, while the accumulation goes on at five or six, the absolute loss becomes very material.

Whenever the money is worth more to the debtor, or, in case of public debt, to the tax-payer, for use in business or for ordinary purposes, than what it will earn by accumulation, then there is always a loss in appropriating it, — whether earned, or raised by loan or by taxes, direct or indirect, — to accumulate in a sinking-fund. For the same reason, in these circumstances, the interest on the accumulation, that is, the interest on the interest compounded, is less in the sinking-fund, and less profitable to the debtor, than it would have been in his own hands and under his own direct proper management.

During the last three years the city of New York has added thirty-seven millions of dollars to its funded debt, seven millions of which have gone directly or indirectly into its sinking-fund; and three or four millions more have been applied as the city's quota to make up for the deficiencies in the State sinking-fund. But the city of New York, it may be said, is exceptional in extravagance of mismanagement; it lives by borrowing, and its example cannot fairly be used in illustration of any principle. And yet, amid the mal-administration, the frauds and the robberies of that city government, they kept up their sinking-fund, in appearance at least, as sanctimoniously and in about as thrifty a condition as such sham expedients for paying debts easily have been maintained elsewhere. The city of Boston also is a constant borrower of

money, and is also all the while increasing its sinking-fund, to the great satisfaction of divers credulous persons ; a million and a half of dollars having been added to that fund the last year. During the same year the addition to the debt of the city for money borrowed was nine or ten millions.

The case of the city of Boston furnishes as conclusive an argument and as convenient an illustration of the worthlessness of the sinking-fund machinery, as any other. The sinking-fund of the city amounts, in round numbers, to \$15,000,000, which is wholly invested in the loans, or certificates of indebtedness, of the city itself. The total debt of the city is about \$43,000,000. But \$15,000,000 of this debt belongs to, and is held by, the city itself. That is, the city of Boston owes to the city of Boston this \$15,000,000. Well, suppose the debtor, the city of Boston, should make default in payment of this \$15,000,000, — and at the present rate of accumulation of debt, municipal bankruptcy is not an impossible hypothesis, — what then? A suit at law is the usual prompter of delinquent debtors. It would be interesting to see what kind of a declaration or complaint would be framed by the learned city functionaries to meet such a case. Doubtless it would be averred that the city of Boston owed the city of Boston this great sum ; the non-payment of which was of great detriment to the city of Boston aforesaid. It is neither agreeable nor useful to trifle with a subject which affects more or less deeply the interests of the community now and hereafter ; but surely there must sometimes spring up in the breasts of the city fathers a feeling of doubt

and misgiving as to the success of this financial expedient, this panacea, this "soothing-syrup" for the ailments of the city treasury. Nor ought it to excite surprise if, in ruminating over this doubt, they should, by and by, fall into the conviction that their whole sinking-fund arrangement is a sham and a delusion, and that they had better purge their account-books of the whole thing; that, instead of calling their debt \$43,000,000 with \$15,000,000 sinking-fund owed by themselves to themselves, they had better call their debt what it actually is, \$28,000,000, and have done with the farce of charging themselves \$15,000,000 additional on one side of their ledger, and crediting themselves with the same sum on the other. If the augurs of ancient Rome found it difficult to restrain a smile when they met each other in the street, how much less difficult must it be, in this waning nineteenth century, for the commissioners of this sinking-fund to preserve becoming gravity when they assemble to deliberate on the business of their charge?

Mr. George S. Boutwell, lately Secretary of the Treasury of the United States, now Senator in Congress, was brought up in the country, and evidently made the best use of such opportunities of learning as came within his reach. But it is obvious that among his studies he did not include the higher mathematics of financiering. During every year of his administration of the Treasury he had a surplus of revenue over expenditure. An illuminated financier, in that situation of affairs, of course would have established a sinking-fund for the ultimate payment of the great debt of the country. But, owing to his

rural education, his study of "Poor Richard's Almanack," or, more than all, to his robust common-sense, Mr. Boutwell did no such thing. He simply paid the debt, as far as his money would go, and cancelled the obligations. Instead, therefore, of having our national debt remaining of its original proportions, or increasing; with a magnificent sinking-fund, charming to financiers, we have no national sinking-fund at all, and only a national debt a few hundred millions less in amount than when Mr. Boutwell began the process of reduction. His method in this particular was simple, straightforward, practical, — intelligible to the least instructed understanding. His whole financial theory resolves itself into the simple proposition, that the best way to sink a debt is to pay it; that the surest sinking-fund is payment. And he has made the country his perpetual debtor by acting upon that theory.

The debt of the country must be paid from the property and earnings of the country. The debt of each state and city and township and corporation is to be paid, every dollar of it, from its property and its earnings. Disguise the matter as you may, envelop the process in the most alluring financial devices, give to the pill the best sugar-covered coating, it comes at last to the same thing; the bolus must be swallowed, the debt must be paid, inexorably paid, out of the assets of the debtor, the tax-payer, the stockholder. It may be easier, or seem easier, to raise a small sum annually, and deposit it as a constantly accumulating fund for the ultimate payment of a debt which is not to mature for a series of years.

And this is the most plausible argument for a sinking-fund. But Mr. Boutwell found no difficulty in dealing with this argument and this state of affairs. He went into the market when he had a small surplus or a large one, and bought up the national bonds. And this every debtor state, or city, or corporation might do, for their bonds are almost always in the market. Indeed most of them, that have sinking-funds, do invest more or less in their own bonds; but instead of cancelling them, and extinguishing so much of their debt, they keep them in reserve, to be reissued, it may be, and resold, as occasion may require. The State of Maine has its sinking-fund invested in its own bonds, due some fifteen years hence; and the policy is to resell these same bonds to provide funds with which to pay other bonds due some years earlier. Perhaps that vigorous and watchful State will lose nothing in the operation; and probably it will not, if the custodians of the bonds continue honest through all these years, and no outside barbarians break in and steal. Still, the Boutwell method is both simpler and safer, as well as cheaper,—to extinguish the debt as far and as fast as means are at hand, even though, in the particular case, it should be necessary to issue new bonds when others outstanding shall mature.

The argument for the sinking-fund is, that it enables the debtor state or city or corporation, whose obligations to a large amount do not mature for ten or twenty or thirty years, or who wishes to make loans for those periods, to provide for payment by accumulating instalments, instead of one great as-

sessment at the end. In many cases, perhaps in the majority, this may be most convenient. But as this convenience is or may be always foreseen when the debt is contracted, why not provide for it at that time in the simpler, cheaper, and safer mode of making the debt itself payable and extinguishable by instalments? Why not issue the bonds payable, some in each year? The additional cost for printers' ink could not be much. Such bonds, indeed, falling due in successive years, might not be so attractive, or quite so readily negotiable in the mass, to the bankers, who prefer not only to deal in large sums, but to make short work of it; but, meeting the views of different classes of investors, they could not fail to find purchasers, and at rates affording as good a return, and, taking into account the other advantages, a better return to the treasury, than the uniform long bonds. The State of Massachusetts has a debt of some \$27,000,000, incurred at various times for different purposes, more or less of which is falling due each year; and each year also new debt is contracted for new objects. The State also has a sinking-fund, or, rather, numerous sinking-funds; the principle having been acted upon, of the contemporaneous creation of a sinking-fund for each permanent loan. And these funds, on the whole, have been safely managed, and rarely encroached upon. But the question naturally arises, why not make the debt itself, in the first instance, at the time of its creation, payable by instalments? Why keep up, unnecessarily, this cumbersome and somewhat expensive and hazardous machinery of twenty sinking-funds? Why contract

an inflated bond-debt for the purpose, or the seeming purpose, of creating an equally swelling fund to meet it? Why make a loan payable in twenty years, when you want to pay it, and mean to pay it, in ten or five years, or part in each year? Take the latest case in illustration. The legislature of the Commonwealth, at its recent session, authorized a loan of a million of dollars, redeemable in not less than twenty years, for the construction of a new State prison, and, at the same time, directed a sinking-fund to be formed for the redemption of that loan (with two others of less amount) out of the proceeds of the sale of the old State prison. Now, according to the official estimate, which doubtless is reliable, of the value of the old prison, \$800,000, the proceeds of its sale will amount to four-fifths of that million loan. And yet the bubble, of that loan and that sinking-fund is to be kept inflated for twenty years to come, subject to all the risks, expenses of management, and changes of that long period; instead of applying the proceeds of the sale of the old, when it shall occur, to the payment for the new, as far as they would go, in accordance with what to men unskilled in financial theories would seem to be the dictates of common prudence and common-sense.

The difference, however, between contracting debt in order to create a sinking-fund to meet it and the maintaining a debt in its entirety in order to accumulate a sinking-fund to redeem it in the end, is not very great in principle, although in practice the latter mode of proceeding is much the most common.

In case the annual loans, or wants of the government for which permanent loans are usually obtained, equal the annual amounts added to the sinking-funds, an obvious suggestion would be, to make the one supply the other; to make the increments of the sinking-fund supply the place of the loan. But this is the shocking thing which British Chancellors of the Exchequer were wont to do, which also, or worse, was done with the New-York fund, and with others. This course, if it prevents additions to the debt, stops also the increase of the sinking-fund, — a fatal objection in the view of that class of financiers to whom debt has no terrors so long as they can see a sinking-fund looming in the future.

One of the mischievous consequences, and not the least baleful at the present day, which results from the delusion of some mysterious efficacy in a sinking-fund to pay debt without burden to the debtor or tax-payer, is the temptation it holds out to municipalities of every name to engage in expenditures for public works and improvements in advance of the needs of the time, under the vague impression that the indebtedness to be incurred for such works may easily be provided for by such a fund, and ultimately paid, without being much felt by the present or the coming generation.

It may be added that the ill success of Dr. Franklin's scheme of accumulation for the benefit of Boston and Philadelphia shows how difficult it is for the wisest of men to forecast the future, and provide against the contingencies of a changing world. By

his calculations, which were arithmetically correct, the £1000 sterling which he gave to each of those cities would, in a century, become £131,000. Five-sixths of that period have already elapsed, and the Boston fund has only reached £36,000; while the Philadelphia fund, it is understood, amounts to less than £6,000. Of course the accumulation in the last years, if there be no further losses, will be more rapid than before; but the final result will fall very far below the Doctor's sanguine expectations. The benevolent philosopher may have been influenced to add this codicil to his will by the writings and computations of his old friend, Dr. Price, showing "what miracles compound interest will work," which were then, A.D. 1789, greatly in vogue, and which undoubtedly had influenced Mr. Pitt, three years earlier, to introduce and carry through his sinking-fund bill.

So far we have been considering the interests of the debtor, and the vanity of his expectations if he trusts to a sinking-fund to shield him from the inexorable doom of actual and absolute payment, out of his own assets, of his debt to the last dollar, principal and interest, with the added cost, certainly, of the management of the fund, and the possible losses from mismanagement or dishonesty in the course of years.

But there is another side to the case, another party whose interests may be deemed perhaps still more direct and more deeply involved in the subject-matter; to wit, the creditor, for the payment of whose debt the sinking-fund is specially provided.

The advantage to a creditor of a sinking-fund is, or should be, that it furnishes an additional security to be applied, directly and specially in the first instance, to the payment of his bond, or which he can fall back upon for payment in case of default of the debtor. The creditor looks upon it as a special fund devoted to the payment of his particular debt, and to be used for no other purpose whatsoever; and such, in general, has been the language of the acts of appropriation ever since Walpole's time.

Now, in the first place, it may be conceded that if a fund is specially set aside by the debtor for the payment of a particular debt, and that fund is so placed as to be absolutely and irrevocably beyond the control of the debtor himself, and also beyond the reach of his general creditors, in case of insolvency, then such a fund, so placed, like a mortgage or any other collateral pledge, does constitute, to that extent, a special security to the particular creditor, available in any event towards payment of his debt. But it is seldom that a sinking-fund is placed, in practice, beyond the debtor's own control, or, in the case of corporations, municipal or private, beyond the reach of their general creditors; so seldom, indeed, that such cases form the exceptions to the usual course of proceeding.

In the second place, when the fund remains under the control of the debtor himself (and of course within the reach of his general creditors), but is invested in outside securities, so to speak, that is, securities other than his own bonds or obligations, in such case the special creditor may be considered

as having a sort of equitable, or at least an honorary lien upon such outside securities; and it is possible that he might, in some instances, have a right to the aid of a court of equity in following such securities, if they should be misappropriated, into the hands of those who were parties to the misappropriation. But, on the whole, the probability of such a right existing, and being practicably capable of enforcement, is rather remote; and such a bond-creditor must place his chief reliance, indeed, in most cases, his whole reliance, as well for payment as for the due preservation of the sinking-fund securities, in the good faith and the continued solvency of his debtor; that is, his legal rights are very little, if at all, strengthened by a sinking-fund invested in such outside securities, so long as they remain under the control of the debtor himself, or within the reach of his general creditors.

Third. If the sinking-fund is invested in the debtor's own bonds or obligations, its existence is not of the least advantage to the creditor. It gives him no additional security, — legal, equitable, or honorary. It simply gives him a second or additional promise of his debtor; a promise no more obligatory, and no more likely to be kept, than the debtor's original promise to pay. In the case supposed, the debtor gives first his original and binding promise to pay the particular debt; then he gives another promise, expressly or impliedly, that he will create, or procure and hold, certain other promises or bonds, of himself to himself, and treat them as a special fund for the payment of the particular debt. Obviously, such additional promise, or concatenation of promises, is of

no value to the creditor ; gives no additional strength to his bond. It is a worthless device so far as he is concerned.

To the creditor, then, the sinking-fund, in most cases, is of no value ; it is never of any value whatever, except in the rare instances in which it is placed absolutely beyond the control of the debtor, and out of the reach of his general creditors. If anybody, therefore, invests money in the bonds of a corporation, municipal or private, relying on such a sinking-fund so remaining within the debtor's power, his investment rests, so far, on a basis wholly shadowy and deceptive. If the debtor is able to pay the original debt, well and good ; but the sinking-fund gives no additional guaranty ; it adds nothing to the security

To the debtor, however, the sinking-fund is always an expense, — often a snare and a delusion. If it tempts him, if it leads any city, town, or state, to contract unnecessary or not indispensable debt, under the futile hope that through its wonder-working accumulations that debt is to be extinguished without the hardships of taxation and self-denial ; without, in short, raising the last dollar of the loan with interest in one form or another, then the sinking-fund is more than an empty delusion ; then it inflicts on persons and communities, for the present and the future, great and positive injury and loss.



